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A Primer on Accord and Satisfaction

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A PRIMER ON ACCORD AND SATISFACTION

Scott J. Burnham*

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“He is well paid that is well satisfied.” Merchant of Venice, IV, 1.

I. INTRODUCTION

Attorneys and lay persons use the principles of accord and satisfaction every day. An understanding of these principles allows disputes to be resolved in an efficient and economical manner. But failure to grasp the principles can lead the unwary into a trap. Furthermore, a statutory gloss on the principles developed by the common law may allow lawyerly technicalities to undermine a common sense result. This article examines these principles and statutes as they have developed in Montana and proposes the means by which courts can maintain the usefulness of this body of

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law as an informal means of dispute resolution.¹

The following situation illustrates the problem. A client calls her attorney and says:

One of our customers owes us \$1000, and we've been having a problem getting him to pay. Today we got a check from him for \$800. On the back of the check, right over where we would endorse it, are the words "accepted in full satisfaction of my obligation." We want to take the money, but we still want to be able to go after him for the other \$200. If we cash the check, have we given up our claim?

To answer this question, it is necessary to examine the common law background of accord and satisfaction and the statutory alterations of the common law.²

II. THE COMMON LAW BACKGROUND

A. *Characterizing the Obligation*

The first step in analyzing an accord and satisfaction problem is to determine (1) whether the obligation is liquidated or unliquidated, and (2) whether it is disputed or undisputed.

1. *Liquidated or Unliquidated*

Liquidated means agreed upon by the parties or determined by the legal process. For example, an agreement between attorney and client that the attorney will perform services for a flat fee of \$1000 results in a liquidated obligation when the services have been performed. On the other hand, if the agreement is that the attorney will bill the client for the reasonable value of the services and the attorney renders a bill for \$1000, the obligation is unliquidated.³ In the latter case, the client did not agree to a fee of \$1000.

1. Good general sources include RESTATEMENT (SECOND) OF CONTRACTS §§ 278-282 (1981); 12 CAL. JUR. 3D, *Compromise, Settlement, and Release* §§ 20-36; 6 A. CORBIN, A COMPREHENSIVE TREATISE ON THE WORKING RULES OF CONTRACT LAW §§ 1268-1302 (1964); E. FARNSWORTH, CONTRACTS §§ 4.23-25 (1982); 42 A.L.R. 4th 12 (1985); McLaughlin, *Section 1-207 and "Full Payment": Finding Concord Amidst Discord*, NAT'L L.J., Nov. 26, 1984, 20; J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE §§ 1-5, 13-21 (2d ed. 1980); J. CALAMARI & J. PERILLO, THE LAW OF CONTRACTS §§ 4-10 to 4-12, 5-16 (2d ed. 1977); Annot., 35 POF2d 735 (1983).

2. Terms used to describe a situation in which the check is offered upon a condition and the payee understands that cashing the check constitutes assent to the condition include "full payment check," "check in full settlement," "conditional check," and "conditioned check." See *Flambeau Prods. Corp. v. Honeywell Inf. Systems, Inc.*, 116 Wis. 2d 95, ___, 341 N.W.2d 655, 658 n.3 (1984).

3. See *Blottner, Derrico, Weiss & Hoffman, P.C. v. Fier*, 101 Misc. 2d 371, 420 N.Y.S.2d 999 (Civ. Ct. Queens Co. 1979).

An example of an obligation liquidated by the legal process appears in *State ex rel. Bishop v. Keating*,⁴ where the court⁵ classified as liquidated the state's obligation to pay the value of cattle killed by order of the livestock board and assessed pursuant to statute.⁶

An unliquidated obligation, such as the attorney's bill based on the reasonable value of services, can become liquidated under the doctrine of *account stated*.⁷ This doctrine has been well articulated in Montana. In *Mattson v. Julian*,⁸ the court stated:

In *Johnson v. Tindall*, we stated that the basic ingredient of an account stated is an agreement that the items of the account and the balance struck are correct and an express or implied agreement for the payment of the balance. Implied agreement for the payment of the balance may be presumed where there is a course of dealings, an antecedent indebtedness, and retention of a statement of the account for an unreasonable length of time without objection.⁹

In *Mattson*, plaintiff construction company sent defendant owner a bill for services in December, 1978 and from time to time thereafter. Defendant made no objection to the amount of the bill until the trial in 1983; in fact, he made a part payment. Applying these facts to the elements of an account stated, the trial court found an implied agreement to pay the amount billed. The court affirmed.¹⁰

The length of time required before an obligation becomes liquidated under the doctrine of account stated depends on the facts and circumstances. In *Mattson*, it was five years. In other cases, it has been as short as two months.¹¹ Proving liquidation of the debt

4. 56 Mont. 526, 185 P. 706 (1919).

5. Unless otherwise stated, "the court" refers to the Montana Supreme Court.

6. The relevant statutes are now found in MONT. CODE ANN. §§ 81-2-201 to -210 (1985).

7. RESTATEMENT (SECOND) OF CONTRACTS § 282 (1981) provides:
Account stated.

(1) An account stated is a manifestation of assent by debtor and creditor to a stated sum as an accurate computation of an amount due the creditor. A party's retention without objection for an unreasonably long time of a statement of account rendered by the other party is a manifestation of assent.

(2) The account stated does not itself discharge any duty but is an admission by each party of the facts asserted and a promise by the debtor to pay according to its terms.

8. ____ Mont. ____, 678 P.2d 654 (1984).

9. *Id.* at ____, 678 P.2d at 658 (citation omitted).

10. *Id.*

11. In *Johnson v. Tindall*, 195 Mont. 165, 635 P.2d 266 (1981), a bill for attorney's services became liquidated when no objection was made for a period of less than two months.

is also significant because it represents the point at which pre-judgment interest begins to accrue.¹²

2. *Disputed or Undisputed*

To make an obligation disputed, the obligor must raise a defense in good faith. The Uniform Commercial Code (UCC)¹³ definition of "honesty in fact"¹⁴ may serve to distinguish meritorious disputes from those raised to chisel the creditor. Whether a dispute exists is a question of fact. For example, in *Jensen v. Cloud*,¹⁵ plaintiff truck driver claimed defendant distributor had promised wages of \$5 per trip but paid only \$4; defendant claimed there was a dispute as to the agreed-upon wages. The jury found that there was in fact no dispute.¹⁶ Similarly, in *Sawyer v. Somers Lumber Co.*,¹⁷ defendant buyer disputed an obligation to plaintiff seller, claiming the right to offset an amount it owed to a third party. The court found that the claim was specious, so the obligation was not disputed.¹⁸

An interesting issue raised in *Sawyer* involves the consequences when the obligor disputes a portion of a debt. Defendant, who owed plaintiff \$835, offset the amount of \$431 and paid plaintiff \$404. Does payment of an undisputed portion of a debt permit the obligor to treat the entire obligation as a disputed one? The court followed the majority rule that it does.¹⁹ Even though defendant admitted to owing \$404, the dispute as to the \$431 made the entire \$835 debt disputed.

B. *The Pre-Existing Duty Rule*

Having classified the obligation, the next step is to determine (1) whether it is both liquidated and undisputed, or (2) whether it is either unliquidated or disputed.

12. MONT. CODE ANN. § 31-1-106(1)(b) (1985).

13. Codified at MONT. CODE ANN. §§ 30-1-101 through 30-9-511 (1985).

14. MONT. CODE ANN. § 30-1-201(19) (1985) provides: "'Good faith' means honesty in fact in the conduct or transaction concerned."

15. 107 Mont. 593, 88 P.2d 36 (1939).

16. *Id.* at 598, 88 P.2d at 39.

17. 86 Mont. 169, 282 P. 852 (1929).

18. *Id.* at 179, 282 P. at 855.

19. "By the great weight of authority a liquidated debt, admitted to be due, is rendered unliquidated by the assertion of a counterclaim or set-off by the debtor, so that it may be discharged by the payment of a smaller amount." *Id.* at 178, 282 P. at 855. The complications arising from this principle are further examined *infra* notes 28-30 and accompanying text.

1. *Liquidated and Undisputed Obligations*

Matthew 18:23-34 tells the parable of the master who discharges the large debt of his servant. The servant, failing to learn the lesson of forgiveness, imprisons his own small debtor. When the master learns of this, he revokes the discharge and imprisons the servant.

This is not only good religion, but good common law. The discharge was not effective because there was no consideration for it. Assume that a \$1000 debt is liquidated and undisputed. The debtor has a duty to pay \$1000. If the debtor offers to pay \$800 in satisfaction of the debt and the creditor accepts the payment, the creditor has an enforceable claim for the \$200 balance. Even though the creditor agreed to accept less, that agreement is not an enforceable contract because it lacks consideration. Since the debtor had a duty to pay the \$800 as part of the \$1000, the debtor gave the creditor no consideration for the creditor's promise to forego \$200.²⁰ This is an application of the "pre-existing duty rule:" there is no consideration when a promisor merely agrees to do what the promisor was already bound to do.²¹

As a practical matter, there are many occasions when a debtor offers part payment to discharge a debt. The creditor, valuing a bird in the hand above two in the bush, may be willing to accept the part payment in full satisfaction. So the law developed ways around the inflexibility of the pre-existing duty rule.²² The creditor could accept a performance different from that originally agreed to. The creditor could accept, in the lovely expression of Lord Coke, "a horse, hawk or robe" instead of full payment.²³ Or the creditor could accept performance at an earlier time or a different place.

Alternatively, the creditor could agree to accept an additional performance. The problem with accepting \$800 in satisfaction of a \$1000 debt is lack of consideration for the \$200 which the creditor foregoes. This problem vanishes if the creditor accepts \$800 and a peppercorn. Since the law does not inquire into the adequacy of consideration, if the parties deem a peppercorn consideration for

20. *Foakes v. Beer*, 9 App. Cas. 605 (1884).

21. FARNSWORTH, *supra* note 1, § 4.21. See *Bose v. Sullivan*, 87 Mont. 476, 288 P. 614 (1930) (subsequent agreement unenforceable in the absence of consideration).

22. Courts could have distinguished cases in which consideration is required to create executory duties from cases where duties are discharged but, alas, they did not. See FARNSWORTH, *supra* note 1, § 4.23.

23. *Pinnel's Case*, 77 Eng. Rep. 237 (1602).

\$200, that is their business.²⁴ A number of jurisdictions recognized that these devices elevated form over substance. In some states, courts simply recognized that creditors benefitted by avoiding the transaction costs of collection and changed the common law rule.²⁵ Others, including Montana, enacted statutes permitting the compromise of liquidated, undisputed obligations without consideration.²⁶

2. *Unliquidated or Disputed Obligations*

The pre-existing duty rule and the devices to avoid it are only applicable when the obligation is liquidated and undisputed, for the problem is lack of consideration. When parties compromise an unliquidated or disputed obligation, however, consideration exists in the determination of the debt or the extinguishment of the claim.²⁷ For example, an attorney retained to perform services at their reasonable value, renders a bill for \$600. The client protests and the attorney accepts \$500 in full satisfaction. The attorney has no claim for the balance. In consideration of the attorney liquidating the obligation, the client has acknowledged and satisfied the obligation. Or if a buyer refuses to pay a \$600 bill for goods sold and delivered on grounds that the goods are defective, the seller's acceptance of \$500 in full satisfaction discharges the obligation. In consideration of the buyer giving up the claim, the seller has foregone \$100.

What if the buyer admits to owing \$500 but claims an offset of \$100 for the defective goods? The seller might accept \$500 in full satisfaction, thinking the claim for \$100 has been preserved. But under the rule enunciated in *Sawyer*, the entire obligation is dis-

24. FARNSWORTH, *supra* note 1, § 2.11. The quaint references to peppercorns can be traced back to Blackstone's COMMENTARIES (1766) and Coke's first INSTITUTE (1628).

25. See, e.g., *Frye v. Hubbell*, 74 N.H. 358, 374, 68 A. 325, 333 (1907):

If costs always equal the expense of litigation, if interest is always full recompense for delayed payment, and if an execution is always equivalent to money in hand, then a present part payment of a debt in cash is in fact never beneficial to the creditor or detrimental to the debtor, and can never be a consideration for a discharge of the balance. Whatever the conclusions of scholastic logic, as men having some acquaintance with affairs judges are bound to know that none of these propositions are always, if ever, true; and as they are not always all true, it cannot be matter of law that in a particular case a part payment was not such a benefit to the creditor or detriment to the debtor as to furnish a consideration for the creditor's agreement of discharge.

The case is discussed in Burnham, *Contract Damages in Montana Part I: Expectancy Damages*, 44 MONT. L. REV. 1, 2-3 (1983).

26. This statute, MONT. CODE ANN. § 28-1-1403 (1985), is analyzed *infra*, Part III.A.

27. FARNSWORTH, *supra* note 1, § 4.23.

puted and has been satisfied by the \$500 payment.²⁸ Displeased with this result, some courts have held that the creditor should be permitted to accept the undisputed amount and retain the right to litigate the disputed amount.²⁹ When the debtor pays only the disputed amount, there is technically no consideration for the discharge of the balance. The better rule is that the debtor has offered the tendered amount for the purpose of concluding the transaction. The law should not permit a creditor who assents to the extinction and discharge of a claim to sue on it later.³⁰ To avoid this controversy, a prudent attorney might advise debtors to tender slightly more than the undisputed amount.

C. Accord and Satisfaction

The parties' agreement to accept partial performance in full satisfaction of an unliquidated or disputed obligation is a form of contract called an *accord*.³¹ The agreement hovers like Tinkerbell until it has been fully performed. The full performance is known as *satisfaction*.³² Accord and satisfaction, then, discharge the original obligation. If the accord is not fully performed, it is breached. The injured party may sue either on the accord or on the original obligation, which is revived by the breach;³³ any partial performance is treated as a payment on account.³⁴ In the example of the attorney billing \$600 for the reasonable value of services, assume the parties reach an accord to settle the obligation for \$500 payable in 30 days. The client pays only \$400 in 30 days. The attorney may treat the accord as breached, revive the \$600 claim, and sue for the \$200 balance due.

While the injured party rarely sues on the accord, it may happen when the obligor promises something different from the prom-

28. See *supra* note 19 and accompanying text.

29. 6 A. CORBIN, CONTRACTS, *supra* note 1, § 1289. This argument provides an alternative foundation for the result achieved by the application of UCC § 1-207. See *infra* notes 61-77 and accompanying text.

30. In *Kilander v. Blickle Co.*, 280 Or. 425, 429, 571 P.2d 503, 505 (1977), the Oregon Supreme Court stated:

It would be too technical a use of the doctrine of consideration to release a well-counseled debtor who tenders a nominal amount beyond his admitted debt but to trap one less sophisticated who is induced to pay the undisputed amount in return for his creditor's illusory promise to forgive the rest.

31. MONT. CODE ANN. § 28-1-1401 (1985).

32. MONT. CODE ANN. § 28-1-1402 (1985).

33. 6 A. CORBIN, CONTRACTS, *supra* note 1, § 1271 at 93-94; FARNSWORTH, *supra* note 1, § 4.24 at 285. A good example is a composition among creditors.

34. In the absence of the debtor's performance of an agreement by the creditor to accept less than full payment, a payment is "merely applied on the debt." *Nett v. Stockgrowers' Fin. Corp.*, 84 Mont. 116, 129, 274 P. 497, 500 (1929).

ise in the original agreement. For example, in *Davis v. Sullivan Gold Mining Co.*,³⁵ defendant employer claimed that plaintiff employee agreed to accept mining company shares in satisfaction of wage claims. When defendant failed to perform, plaintiff had the choice of suing for either the wages or the shares.

Since an accord is a contract, the agreement to settle an unliquidated or disputed obligation must satisfy not only the requirement of consideration but all the criteria of contract formation.³⁶ Offer and acceptance must be present. The law favors settlement, but it must be a knowing settlement, clearly communicated to each party.³⁷ A notation endorsed on a check is not sufficient to create an accord without a prior understanding or an accompanying notice.³⁸ The offeree must either accept the offer on its terms or reject it. A creditor who, knowing that an obligation is unliquidated or disputed, strikes off the restrictive endorsement or holds the check for an unreasonable amount of time, may well have accepted the settlement.³⁹

D. Substituted Contract

A fruitful source of difficulty is the failure of the parties to distinguish between an *accord and satisfaction* and a *substituted contract*. When parties enter an accord, the obligee agrees to forego part of the obligation in exchange for some consideration from the obligor. They usually intend that consideration to be *performance* of the obligor's new promise. The old agreement hovers until the performance is complete and can be revived if performance is not completed.

But parties may at any time rescind their original contract and form a new contract.⁴⁰ They mutually discharge the duties

35. 103 Mont. 452, 62 P.2d 1292 (1936).

36. 6 A. CORBIN, CONTRACTS, *supra* note 1, § 1277. See *Hicks v. Stillwater Co.*, 84 Mont. 38, 274 P. 296 (1929) (no contract where mutual mistake).

37. In *Kibler v. Frank L. Garrett & Sons, Inc.*, 73 Wash. 2d 523, 439 P.2d 416 (1968), the court held that neither a printed notation on a check nor ambiguous language in an accompanying letter were sufficient to communicate an offer to enter an accord and satisfaction.

38. 6 A. CORBIN, CONTRACTS, *supra* note 1, § 1293.

39. This is one of the few instances of acceptance by silence. See *Barbarich v. Chicago, M., St. P. & P. Ry. Co.*, 92 Mont. 1, 15, 9 P.2d 797, 801 (1932); Annot., 42 A.R.R. 4th 117 (1985).

The issue of whether *certification* of a check constitutes acceptance of an offer of accord is discussed at Annot., 42 A.L.R. 4th 95 (1985).

40. This new agreement is also called a novation, although the common practice is to use *novation* when the new obligation is undertaken by a third party and *substituted contract* when it is undertaken by the same parties. 6 A. CORBIN, CONTRACTS, *supra* note 1, § 1293 at 190.

under the old contract and accept new promises. Each promise in the new contract is good consideration for the other.⁴¹ The old contract does not hover, but is extinguished as soon as the new, substituted contract is made. In compromising an obligation by entering a substituted contract, an obligee settles for the promise of performance, not performance itself.

Under a substituted contract, therefore, if the obligor does not perform, the obligee is stuck with enforcing the new promise.⁴² An obligee may claim an accord was intended, but since courts measure intention objectively, careless expression can lead to an unintended result. For example, A has a \$10,000 tort claim against B.⁴³ After negotiations, A promises to release B in exchange for B's promise to pay A \$5000 within 30 days. B does not pay. A, thinking an accord has been breached, revives the tort claim. B raises the affirmative defense of accord and satisfaction.⁴⁴ B's defense is a good one. A originally had an unliquidated claim and B had a potential liability. The parties discharged this claim and agreed to new obligations: A's promise to release B and B's promise to pay the liquidated amount of \$5000. A valid substituted contract has been formed.⁴⁵ B has breached that contract; A's remedy is to sue

RESTATEMENT (SECOND) OF CONTRACTS § 280 (1981) defines novation as exclusively a substituted contract that includes a third party, but Montana Code Annotated defines it to include a new contract between the same parties as well. MONT. CODE ANN. § 28-1-1502 (1985) states:

Novation is made by the substitution of:

- (1) a new obligation between the same parties with intent to extinguish the old obligation;
- (2) a new debtor in place of the old one with intent to release the latter; or
- (3) a new creditor in place of the old one with intent to transfer the rights of the latter to the former.

41. RESTATEMENT (SECOND) OF CONTRACTS § 71 (1981).

42. An accord that contemplates performance is often called an *executory accord* or *accord executory*. 6 A. CORBIN, CONTRACTS, *supra* note 1, § 1269. If an obligee sues on the original contract, the obligor may raise as defenses accord and satisfaction or substituted contract, either of which would prevent the obligee from reviving the original contract. An executory accord is not a defense, for if the obligor does not perform the executory accord, the obligee may revive the original contract.

43. Note that a claim may serve as the basis for an accord. The Montana statutes provide for an accord and satisfaction to discharge an obligation. MONT. CODE ANN. §§ 28-1-1401, -1402 (1985). An obligation may arise either by contract or by operation of law. MONT. CODE ANN. §§ 27-1-105, 28-1-101, -102 (1985).

44. MONT. R. Civ. P. 8(c) requires that accord and satisfaction be pleaded as an affirmative defense. In *Nett v. Stockgrowers' Fin. Corp.*, 84 Mont. 116, 274 P. 497 (1929) and *Nelson v. Young*, 70 Mont. 112, 224 P. 237 (1924), parties who failed to plead the affirmative defense were not allowed to raise it at trial.

45. This example points out that the term "substituted contract" is a misnomer; the original obligation may be a mere claim. 6 A. CORBIN, CONTRACTS, *supra* note 1, § 1268.

for \$5,000.⁴⁶

The prudent attorney should protect the client against an unsecured promise by stipulating a remedy for its breach. For example, in this situation the stipulation and order of dismissal could provide that if B does not pay the \$5,000 in 30 days, A may enter judgment for the full amount of the claim, less payments made. If the promise is for a substantial future performance, as in a structured settlement, the payment should be secured. Obtaining a promissory note is not sufficient. The note is merely a promise to pay. If a creditor accepts a note in satisfaction and the note is unpaid, the creditor may sue on the note but may not revive the original claim.⁴⁷

If the parties do not express their intention, determining that intent becomes, as with any contract, a question of interpretation.⁴⁸ In determining whether the parties intended the promise or the performance to discharge the obligation, courts consider: (1) whether the parties formed the new contract before any breach of the original; (2) if after breach, whether the breach was disputed; (3) if after breach, whether the amount of the claim for breach was liquidated. In case (1) it looks more like substituted contract; in (2) and (3), more like accord and satisfaction.⁴⁹

In the example of the attorney who has an unliquidated claim for \$600 worth of services, it could be fatal for the attorney to bill the client for \$500 after the accord is reached. If the client breaches the accord, the attorney wishes to revive the original \$600 claim. The bill for \$500, however, is strong evidence that a substituted contract was formed. In the new contract, the attorney's agreement to accept \$500 is consideration for the client's promise to pay that liquidated amount. Following the wiser course, an attorney should make express the intention to form an accord by sending a bill for \$600 with a notation on the bill that it may be

46. Imagine trying to explain *that* to your client!

47. 6 A. CORBIN, *CONTRACTS*, *supra* note 1, § 1293 at 195. See *Gallaher v. Theilbar Realities*, 93 Mont. 421, 18 P.2d 1101 (1933) (part payment in cash and a note for the balance discharged the obligation). Courts have been known to let creditors off the hook by stating that the note was taken as a "conditional payment," i.e., with the intention of reviving the original obligation if the note were not paid. Acceptance of a check, on the other hand, does not operate as payment of the sum due until the check has been paid. *Kalman v. Treasure Co.*, 84 Mont. 285, 275 P. 743 (1929).

48. 6 A. CORBIN, *CONTRACTS*, *supra* note 1, § 1293.

49. E. IMWINKLEID, *HANDBOOK FOR THE TRIAL OF CONTRACTS LAWSUITS*, 303-306 (1981). This issue is analyzed in *Goggins v. Bookout*, 141 Mont. 449, 378 P.2d 212 (1963); *Flint v. Mincoff*, 137 Mont. 549, 353 P.2d 340 (1960); *Davis v. Sullivan Gold Mining Co.*, 103 Mont. 452, 62 P.2d 1292 (1936); *Barbarich v. Chicago, M., St. P. & P. Ry. Co.*, 92 Mont. 1, 9 P.2d 797 (1932).

satisfied by the payment of \$500 within 30 days. The attorney would thereby make clear that the promise of performance constituted the consideration for the \$100 reduction.

In an interesting Montana case, *Barbarich v. Chicago, Milwaukee, St. Paul & Pacific Railway*,⁵⁰ plaintiff had a tort claim against defendant railroad. After negotiating a settlement of plaintiff's claim for \$500 and a railway pass, defendant sent a check and the pass to plaintiff's lawyer, Wellington Rankin. Plaintiff then repudiated the settlement. Defendant first claimed that plaintiff had settled the claim for its *promise* of payment, not the performance. Analyzing the intent, the court held that the parties intended to settle the obligation by performance.⁵¹ Defendant next claimed that since it had performed by delivering the draft and pass to Rankin, the obligation was satisfied by accord and satisfaction. The court held that there was no performance, for defendant tendered a check rather than cash, and Rankin lacked authority to endorse the check.⁵²

III. STATUTORY CHANGES

A. *Liquidated and Undisputed Obligations*

While common law theories of contract formation were adequate to permit the compromising of unliquidated or disputed obligations, there remained the problem of settling liquidated and undisputed obligations. As a practical matter, parties may wish to settle without tendering an alternative performance such as "a horse, hawk or robe." Montana Code Annotated section 28-1-1403 provides the solution. The statute avoids the pre-existing duty rule by enabling the parties to settle a liquidated and undisputed obligation without consideration:

When part performance extinguishes obligation. Part performance of an obligation, either before or after a breach thereof, when expressly accepted by the creditor in writing in satisfaction or rendered in pursuance of an agreement in writing for that purpose, though without any new consideration, extinguishes the obligation.

It is a relatively simple matter to track the statute to determine whether all the elements have been satisfied. Was the obligation liquidated and undisputed? To avoid confusion, the statute

50. 92 Mont. 1, 9 P.2d 797 (1932).

51. *Id.* at 14, 9 P.2d at 800.

52. *Id.* at 15, 9 P.2d at 801.

should be applied only to liquidated and undisputed obligations. For example, A sends a \$600 bill to B, who disputes the obligation. A and B orally agree that B may satisfy the obligation with a payment of \$500. B performs. Is the obligation satisfied? Under the statute, it appears it is not, for the creditor's acceptance of part performance was not in writing. But it is satisfied, for B supplied consideration by giving up the dispute. Fewer errors of this sort will result if the statute is reserved for liquidated and undisputed obligations, which require a substitute for consideration.⁵³

Was there an agreement to accept part performance? Common law standards of contract formation assist in this determination. Was the agreement in writing and expressly accepted? In *Sawyer*, the court held that the creditor's mere endorsement on a check is not the kind of express acceptance contemplated by the statute.⁵⁴ This decision is wise. The obligor of a disputed obligation must give notice of the dispute independently of the check.⁵⁵ Similarly, the obligor of an undisputed obligation should make clear to the obligee that the obligation is being compromised by acceptance of the check. In the case of volume creditors, who routinely endorse checks without reading the restrictions, a contrary ruling could be catastrophic.⁵⁶

Was there performance of the agreement? A substituted contract cannot arise under the statute, for it states that "[p]art performance of an obligation . . . extinguishes the obligation."⁵⁷ This language makes clear that performance, and not the promise of performance, is required. Note, however, that the statute requires part performance of the obligation. "Part performance" must refer to the creditor's agreement to accept less than full performance of the obligation. It cannot mean that the debtor may extinguish the obligation by performing less than the full extent of the new per-

53. For an example of its misapplication, see *Kelly v. David D. Bohannon Org.*, 119 Cal. App. 2d 787, —, 260 P.2d 646, 649-50 (1953), which cites the corresponding California statute, CAL. CIV. CODE § 1524, and states "[a]n accord and satisfaction must be predicated upon a bona fide dispute, a real dispute."

54. *Sawyer v. Somers Lumber Co.*, 86 Mont. 169, 177, 282 P. 852, 854 (1929).

55. See *supra* notes 37-38 and accompanying text.

56. See *Consolidated Edison Co. v. Arroll*, 66 Misc. 2d 816, 322 N.Y.S.2d 420 (Civ. Ct. N.Y. Co. 1971), in which the court rejected a claim by plaintiff, a large utility, that the "nature and volume of its operations does not allow for an examination of each and every check it receives for language written thereon which could bind it to an accord and satisfaction." Under the facts, defendant was not relying on the statute but on a dispute clearly communicated in a separate writing.

The facts of *Arroll* form the basis for the proof of an accord and satisfaction offered in *Annot.*, 35 POF2d 735, 754-61 (1983).

57. MONT. CODE ANN. § 28-1-1403 (1985) (emphasis added).

formance agreed to by the creditor. The purpose of the statute is to dispense with consideration, not to dispense with the principle that a breached accord revives the original obligation. For discharge, it requires the debtor's full performance of the part of the original performance which the creditor agreed to accept.

Application of the statute may be seen in a California case,⁵⁸ in which P obtained judgment against D for \$465.06 plus interest and costs. P agreed in writing to accept payment of \$483.34 in monthly installments of \$50 in full satisfaction of the obligation. D made payments aggregating \$363.48 and then defaulted. P sought execution for the unpaid balance of the original judgment and D moved to stay execution. The Court of Appeal allowed the execution on grounds that there was no satisfaction of the accord, stating that the statute "has no application to the circumstances of the present case."⁵⁹ The result is correct; the reasoning is not. This was a liquidated obligation, determined by the trial court that issued judgment.⁶⁰ Because there was no consideration for the creditor's agreement to accept less, no accord could be formed under the common law. The agreement to accept less was effective only because of the statute. Applying the statute to the facts, the creditor agreed in writing to accept part performance, but the debtor did not fully perform under the new agreement. Therefore the original obligation was revived. The payments made were credited as payments on account and the creditor was entitled to execution for the unpaid balance.

B. *A Monkey Wrench in the Works: UCC Section 1-207*

Application of the principles of accord and satisfaction should assist parties in making knowing, deliberate, and expeditious resolution of their disputes. However, this assistance fails because some courts apply section 1-207 of the Uniform Commercial Code to this situation. The section provides:

Performance or acceptance under reservation of rights. A party who with explicit reservation of rights performs or promises performance or assents to performance in a manner demanded or offered by the other party does not thereby prejudice the rights reserved. Such words as "without prejudice", "under protest" or the like are sufficient.

Creditors use the statute in this situation. A debtor communicates

58. *Blumer v. Madden*, 128 Cal. App. 2d, 16 P.2d 319 (1932).

59. *Id.* at ____, 16 P.2d at 321.

60. See *supra* notes 3-5 and accompanying text.

a dispute to a creditor. The debtor tenders a check for part payment with the notation "accepted in full satisfaction," over the endorsement, inviting an accord and satisfaction. The creditor endorses the check, adding the words "accepted without prejudice." The creditor intends to reject the debtor's attempt at an accord and satisfaction, accept the payment as a payment on account, and reserve a claim for the balance. Will the creditor succeed?

Authority is sharply divided.⁶¹ The differing views of courts in South Dakota, Wisconsin, and New York are useful in analyzing this question. In *Scholl v. Tallman*,⁶² the Supreme Court of South Dakota, upholding a creditor's right to collect the balance of an obligation where the creditor crossed out the debtor's conditional endorsement and wrote "Restriction of payment in full refused," stated:

We do not agree with the defendant's contention that this result dictates the demise of accord and satisfaction as an effective method of commercial compromise. The doctrine has long been an effective method of avoiding litigation; it will serve that function whenever rights are not explicitly reserved. It remains available as a device to facilitate the private resolution of honest disputes through compromises made in good faith.⁶³

If this court desired to prevent chiseling by limiting accord and satisfaction, it may have gone too far, for the decision may prevent all informal compromises, not just the coerced ones. At best, it shifts the advantage to creditors, leaving them in a position to coerce debtors who have offered an accord in good faith. Furthermore, just as it may take a sophisticated creditor to use the statute, a sophisticated debtor can make the offer conditional on the creditor's not invoking the statute.⁶⁴ This "Battle of the Conditional Check Endorsements" brings us a long way from a dispute resolution device that is accessible to lay persons as well as to so-

61. The many cases on this topic are collected at Annot., 37 A.L.R.4th 358 (1985). Law review citations may be found in *Flambeau Prods. Corp. v. Honeywell Inf. Systems, Inc.*, 116 Wis. 2d 95, —, 341 N.W.2d 655, 659 n.4 (1984). See also *McLaughlin*, *supra* note 1, and *WHITE AND SUMMERS*, *supra* note 1, §13-21.

62. 247 N.W.2d 490 (S.D. 1976).

63. *Id.* at 493.

64. For example, in a letter to the *National Law Journal*, December 10, 1985, a Chicago attorney recommended that the debtor use this language:

Payment in full. Upon cashing this check the creditor agrees to fully discharge the debtor from liability arising out of (specified obligation) and further agrees not to reserve any rights with respect to that obligation and waives his right to use Section 1-207 of the Uniform Commercial Code. The return or destruction of this check shall mean that the creditor has rejected these conditions, but the act of cashing it shall be deemed to be conclusive evidence that he has accepted them.

phisticated attorneys.

As long as we must live with the statute, the proper question is not whether use of it to defeat an accord and satisfaction is desirable, but whether the legislature intended it. In rejecting application of this statute to the common law doctrine of accord and satisfaction in *Flambeau Products Corp. v. Honeywell Information Systems, Inc.*,⁶⁵ the Supreme Court of Wisconsin looked to the Official Comments to the UCC, the legislative history, and rules of construction. The Official Comments make no reference to the statute's applicability to accord and satisfaction. The Comments suggest that the statute did not change common law, but clarified a party's rights during a continuing course of performance.⁶⁶ For example, in the famous "chicken" case, buyer, who was shipped stewing chickens when it expected fryers, sent seller a cable stating that it was accepting the shipment without prejudice to its rights to recover damages and to receive frying chickens in future deliveries.⁶⁷ While the court in *Flambeau* based its reasoning on the Comments, a trial court in Pennsylvania strengthened this analysis with reference to the *text* of the UCC.⁶⁸ This court based its conclusion that the statute is inapplicable to accord and satisfaction on the fact that section 1-207 "refers only to performance and does not mention payment."⁶⁹ The court observed that where the UCC intends a statute to apply to payment, as in section 1-208, it mentions both performance and payment.⁷⁰

The study of Wisconsin legislative history in *Flambeau* showed that an earlier draft of Article 3 included a codification of common law accord and satisfaction. The drafters later dropped this provision. The court inferred that the presence of the two sections in the same draft suggested that each addressed a different need. Therefore, section 1-207 could not address accord and satisfaction.⁷¹ Turning to rules of construction, the court noted that the UCC states in section 1-102(1) that it "shall be liberally construed and applied to promote its underlying purposes and policies," one of which is to "simplify, clarify, and modernize the law governing

65. 116 Wis. 2d 95, 341 N.W.2d 655 (1984).

66. *Id.* at ____, 655 N.W.2d at 660-61.

67. *Frigalment Importing Co. v. B.N.S. Int'l Sales Corp.*, 190 F. Supp. 116 (S.D.N.Y. 1960).

68. *KCF Constr. Inc. v. Amper*, 36 U.C.C. Rep. Serv. 369 (Pa. Ct. C. P. Allegheny Co. 1983).

69. *Id.* at 375.

70. *Id.*

71. *Flambeau*, 116 Wis. 2d at ____, 341 N.W.2d at 661-62. This negative inference does not seem justified. The drafters might also have dropped the reference in Article 3 because it duplicated another provision.

commercial transactions." The court reasoned that the simplification of the resolution of commercial disputes would be better served by the common law of accord and satisfaction.⁷²

New York has adopted a middle position. That state's legislative history specifically refers to the application of the statute to payment as well as to performance.⁷³ Therefore, the statute is effective when used in transactions involving the sale of goods, i.e., Article 2 of the UCC.⁷⁴ This seems illogical. The state makes the statute applicable to Article 2 transactions, but the section is in Article 1. The Article 1 provisions apply throughout the UCC, including Article 3, which deals with the use of checks. Therefore, it should apply to a conditional check for services as well as to the sale of goods. At best, the New York rule establishes consistency, but that is debatable given the amount of litigation over whether a transaction involves the sale of goods.⁷⁵ And New York courts are divided on the effectiveness of the statute in non-UCC transactions, such as real estate sales and services.⁷⁶

All of these decisions overlook the fact that when a court applies the statute to accord and satisfaction, it improperly characterizes the behavior of the parties. Assume that the parties first agree to an accord and the debtor later performs by payment. The creditor could not invoke section 1-207 when the debtor pays, for the statute contemplates reservation of rights in the face of defective performance.⁷⁷ There is no defective performance when the debtor performs pursuant to the terms of an accord. Assume, alternatively, that the debtor tenders a conditional check. The debtor is

72. *Id.* at ___, 341 N.W.2d at 661-62. See also *Connecticut Printers, Inc. v. Gus Kroesen, Inc.*, 134 Cal. App. 3d 54, 184 Cal. Rptr. 436 (1982).

73. REPORT OF THE COMMISSION ON UNIFORM STATE LAWS TO THE LEGISLATURE OF THE STATE OF N.Y. 19-20 (1961), incorporated as New York Annotations in N.Y. U.C.C. § 1-207 (McKinney 1964).

74. *Braun v. C.E.P.C. Distribs., Inc.*, 77 A.D.2d 358, 433 N.Y.S.2d 447 (1st Dep't 1980).

75. *WHITE AND SUMMERS, supra* note 1, § 2-2. In *Geelan Mech. Corp. v. Dembar Constr. Corp.*, 97 A.D.2d 810, 468 N.Y.S.2d (1983), the court first had to resolve whether a construction subcontract was a UCC transaction; determining that it was not, the court then held that the statute was not effective.

76. *Gimby v. Frost*, 84 A.D.2d 806, 444 N.Y.S.2d 143 (2d Dep't 1981) (sale of real property; statute not effective); *Ayer v. Sky Club, Inc.*, 70 A.D.2d 863, 418 N.Y.S.2d 57 (1st Dep't 1979), *appeal dismissed*, 48 N.Y.2d 705, 397 N.E.2d 758, 422 N.Y.S.2d 68 (1979) (sale of services; statute effective).

77. Official Comment 1 states:

This section provides machinery for the continuation of performance along the lines contemplated by the contract despite a pending dispute, by adopting the mercantile device of going ahead with delivery, acceptance, or payment "without prejudice," "under protest," "under reserve," "with reservation of all our rights," and the like.

(Emphasis added).

offering simultaneously to enter an accord and to perform it. By invoking the statute in these circumstances, the creditor must be characterizing as defective the performance under the *original* agreement. But this misstates the transaction. The debtor is not defectively performing the original transaction; the debtor is offering to enter into a new transaction. Courts should not permit a creditor to reject an offer while accepting its benefits on the basis of a knowingly wrongful characterization.

IV. GOOD FAITH

There is a tension in the law of accord and satisfaction. On the one hand, the principles permit inexpensive and informal resolution of disputes outside of court. On the other hand, a chiseler can easily raise a phony dispute in order to escape the full extent of an obligation. This concern has engendered a number of criticisms of the law. One authority refers to the debtor's offer to pay an amount less than the total debt as "an exquisite form of commercial torture."⁷⁸ A student note goes so far as to suggest that "[t]he positions of the parties to an accord and satisfaction are frequently the reverse of the classic debtor-creditor relationship, with the creditor practically at the mercy of the so-called debtor."⁷⁹ Because of the high transaction costs of recovering the full obligation (i.e., recovery of minimal costs, low interest, and no recovery of attorneys' fees), the creditor will often be forced by economic reality to accept the lesser amount.⁸⁰

If the creditor spurned the lesser amount and took the debtor to court, exposing the chiseler's scheme, the victory would be Pyrrhic. The phoniness of the dispute would not increase the recovery or reduce the transaction costs of the creditor.⁸¹ But this would not

78. WHITE AND SUMMERS, *supra* note 1, § 13-21 at 544.

79. Note, *Role of the Check in Accord and Satisfaction: Weapon of the Overreaching Debtor*, 97 U. PA. L. REV. 99, 100 (1948).

80. See the discussion of transaction costs in Montana in Burnham, *Contract Damages in Montana Part I: Expectancy Damages*, 44 MONT. L. REV. 1, 47-49 (1983).

81. A colorful, if archaic, example is found in *Hackley v. Headley*, 45 Mich. 569, 8 N.W. 511 (1881), *aff'd after remand*, 50 Mich. 43, 14 N.W. 693 (1883). Headley obtained payment of \$4000 in full satisfaction of a \$6200 claim against Hackley. The court described the circumstances under which this accord and satisfaction came about as follows:

Hackley told Headley to come in again in the afternoon, and when he did so Hackley said to him: "My figures show there is 4,260 and odd dollars in round numbers your due, and I will just give you \$4,000. I will give you our note for \$4,000." To this Headley replied: "I cannot take that; it is not right, and you know it. There is over \$2,000 besides that belongs to me, and you know it." Hackley replied: "That is the best I will do with you." Headley said: "I cannot take that, Mr. Hackley," and Hackley replied, "You do the next best thing you are a mind to. You can sue me if you please." Headley then said, "I cannot afford to sue you,

be so if the creditor could obtain a recovery for the independent tort of breach of the covenant of good faith. This covenant is implied in UCC transactions: "Every contract or duty within this Act imposes a duty of good faith in its performance or enforcement."⁸² California has upheld the principle of tort liability for breach of this obligation in a contract between parties of roughly equal bargaining power.⁸³ The Supreme Court of California stated:

It has been held that a party to a contract may be subject to tort liability, including punitive damages, if he coerces the other party to pay more than is due under the contract terms, through the threat of a lawsuit, made "without probable cause and with no belief in the existence of the cause of action." There is little difference, in principle, between a contracting party obtaining excess payment in such manner, and a contracting party seeking to avoid all liability on a meritorious contract claim by adopting a "stonewall" position ("see you in court") without probable cause and with no belief in the existence of a defense. Such conduct goes beyond the mere breach of contract. It offends accepted notions of business ethics. Acceptance of tort remedies in such a situation is not likely to intrude upon the bargaining relationship or upset reasonable expectations of the contracting parties.⁸⁴

If tort liability may be imposed when a party coerces another into paying more than is due or when a party seeks to avoid all liability without any excuse, it should also be imposed when a party seeks to compromise an obligation by asserting a fictitious dispute. In all these instances, one party is forced to go to court to prove that the other acted in bad faith. If the covenant of good faith and fair dealing were implied in every contract, as it is in California,⁸⁵ the principle would be applicable to every accord and satisfaction, not just those arising under the UCC, where the cove-

because I have got to have the money, and I cannot wait for it. If I fail to get the money to-day, I shall probably be ruined financially, because I have made no other arrangement to get the money only on this particular matter." Finally he took the note and gave the receipt, because at the time he could do nothing better, and in the belief that he would be financially ruined unless he had immediately the money that was offered him, or paper by means of which the money might be obtained.

After two trips to the Michigan Supreme Court, Headley obtained judgment for the full amount.

82. MONT. CODE ANN. § 30-1-207 (1985). See Summers, "Good Faith" in *General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195 (1968).

83. *Seaman's Direct Buying Serv., Inc. v. Standard Oil Co. of Cal.*, 36 Cal. 3d 752, 686 P.2d 1158, 206 Cal. Rptr. 354 (1984).

84. *Id.* at 770-71, 686 P.2d at 1167, 206 Cal. Rptr. at 363 (citations omitted).

85. *Id.* at 769, 686 P.2d at 1166, 206 Cal. Rptr. at 362.

nant is expressed by statute.

Montana could impose liability on the chiseler under existing law. In *Tribby v. Northwestern Bank of Great Falls*,⁸⁶ the court stated that "[w]e are not holding that every contract or statutorily imposed obligation, alone, carries with it an implied covenant of good faith and fair dealing, the breach of which permits recovery in tort."⁸⁷ The court could, however, hold that every contract contains an implied covenant of good faith and fair dealing without holding that the breach of that covenant permitted recovery in tort. Where the court has imposed tort liability for breach of the implied covenant, the elements have included reckless disregard for the rights of another, unequal bargaining power, and breach of an obligation.⁸⁸ When a debtor raises a phony dispute to escape an obligation, the elements of breach and reckless disregard are clearly present. While bargaining power is generally examined at formation of the contract, it could be said that coercion by the debtor puts the creditor in a situation where, because of the economic expense of refusing to capitulate, the creditor lacks bargaining power.

V. CONCLUSION

Montana is yet to rule on the applicability of UCC section 1-207 to accord and satisfaction. It is my hope that the state would join those rejecting the application of section 1-207 to conditional checks. The public, both sophisticated and unsophisticated, has access to a simple and inexpensive dispute resolution mechanism through accord and satisfaction. They should not be denied it by strained statutory construction. The concern that obligors will abuse the principles by raising baseless disputes in order to escape their obligations can be answered by holding that this practice is a breach of the covenant of good faith, subjecting them to tort liability.

The following flow chart⁸⁹ outlines the information an attorney would need to obtain to resolve an accord and satisfaction question and projects the consequences of each alternative:

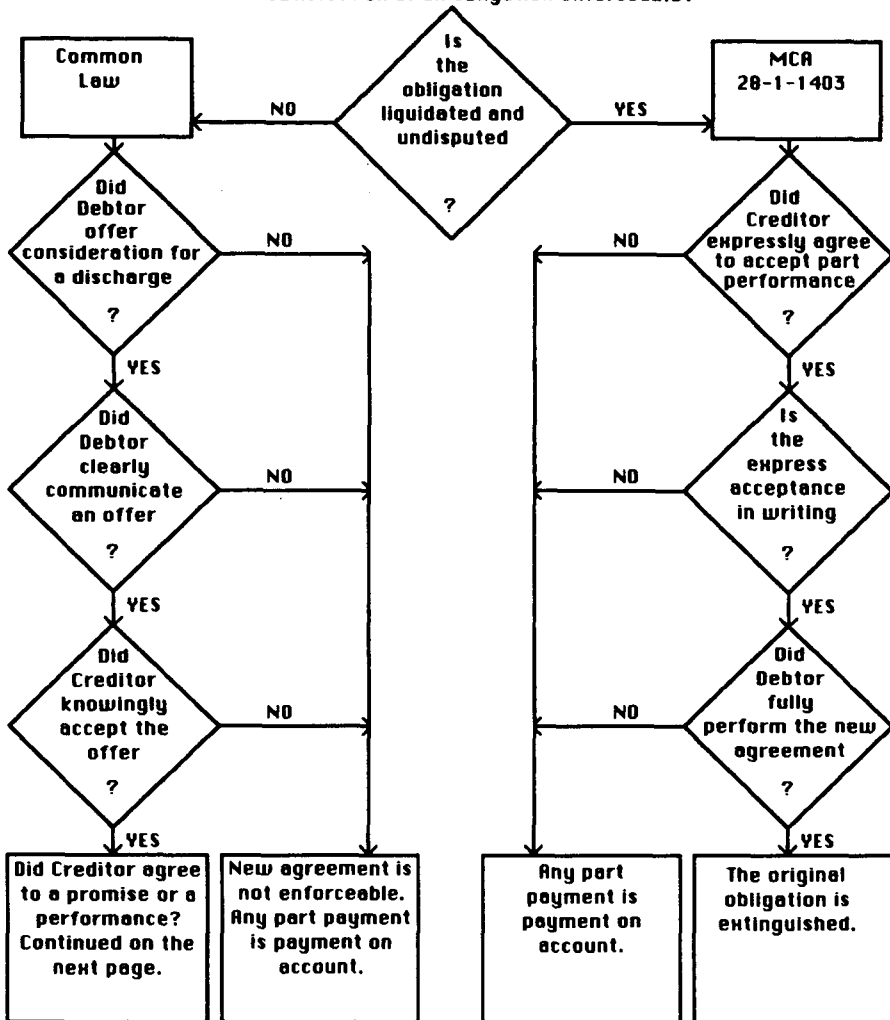
86. ____ Mont. ____, 704 P.2d 409 (1985).

87. *Id.* at ____, 704 P.2d at 419.

88. *Id.* (citing *First Nat'l Bank in Libby v. Twombly*, ____ Mont. ____, 689 P.2d 1226 (1984)). See also Graham and Luck, *The Continuing Development of the Tort of Bad Faith in Montana*, 45 MONT. L. REV. 43 (1984).

89. This flow chart was prepared with the assistance of Douglas S. Freeman, a student at the University of Montana School of Law.

ACCORD and SATISFACTION
 Is a creditor's agreement to accept part payment
 in full satisfaction of an obligation enforceable?



ACCORD and SATISFACTION
Continued from the previous page

